

The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. 35 ILCS 630/3 (1996 State Bar Edition). (This is a GIL).

October 21, 1999

Dear Xxxxx:

This letter is in response to your letter dated June 30, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

I respectfully ask your decision upon a sales tax issue. We have recently begun a new enterprise that reaches into many states and is generating much internet activity.

I will be describing these transactions using specific states; however, I would appreciate your evaluation of this issue based solely upon your state's participation in these transfers. I will be addressing this issue including other state's involvement in order that you may clearly determine if there is any tax liability and with whom such liability rests.

Our company is a healthcare software manufacturer and distributor based entirely in IL. We also have a Data Center on our premises in IL. The Data Center permits storage, retrieval and processing of healthcare claims and information. There is no transfer of software to our clients during any of the processing or other functionality of the Data Center. It is a dial-in capability through common modems or the via the internet.

Our new activity involves electronic file manipulations with respect to the following situation:

Claims are submitted electronically by healthcare providers in any of the 50 states to two different clearinghouses.

The clearinghouses are headquartered in STATE and STATE. The claims are generated and routed through any of the 50 states.

In addition, paper claims are scanned or data entered by vendors and converted into electronic claims. The scanners of the paper

claims who are transmitting the converted electronic claims are in IL and STATE.

The electronic claims from both of the above instances are then delivered to or retrieved by our Data Center in IL. Value is added by our company through multiple-source consolidation and format translation.

After the source consolidation and format translation process, the claims may be copied into our customers' Data Center filespace. The claims transactions then become part of the Data Center transactions which we normally review for taxation in the various states where our customers are located. For non-Data Center customers, the claims are retrieved via the internet, again occurring in multiple states.

The electronic file movement is completely separate from Data Center transactions whose nature are of a 'timesharing' capacity. The electronic file transfer is a movement of data files which are at no point 'owned' by our company.

I understand that there may be three or more issues involved. One issue relates to our procuring the converted paper claims from the vendors in IL and STATE. Another issue relates to our procuring the files from the clearinghouses. The third issue relates to the retrieval through the internet by our non-Data Center customers. In your consideration of these issues, I would appreciate your comments regarding any other issues that you would deem of consequence.

Our concern relates to the taxability of the above processes. Our company is registered in all the states involved. If any portion of this is considered a 'resale' transaction, we would want to provide the vendors or clearinghouses with resale certificates. We are currently being charged a telecommunications tax upon transactions originating in STATE by one of the clearinghouses. As an example, if this is a resale transaction, we would want to provide a resale certificate to the clearinghouse for the telecommunications tax being charged to us. We would then pass the tax along to the end consumer. It would seem that the customer would be required to pay any sales taxes due upon the value-added product if a taxable liability exists. If this is not a resale transaction, does a tax liability exist for the original file transfer, such liability being born by our company, and another liability for the value-added transfer, the liability of such being the responsibility of the consumer?

I would appreciate your evaluation of the above with your response as to taxability in your state.

Thank you for your consideration.

Your letter does not detail the transactions you describe in sufficient detail for us to provide a specific response. However, we hope the following information will be useful.

The Telecommunications Excise Tax is imposed upon the act or privilege of originating or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charges for such telecommunications purchased at retail from retailers. 35 ILCS 630/3 (1994 State Bar Edition). This tax must be collected from persons by "retailers maintaining a place of business in Illinois." 35 ILCS 630/5 (1996 State Bar Edition). "Gross charges" means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer. See 86 Ill. Adm. Code 495.100, enclosed. "Telecommunications" does not include "charges for the storage of data or information for subsequent retrieval or the processing of data or information intended to change its form or content" or "value-added services in which computer processing applications are used to act on the form, content, code and protocol of the information for purposes other than transmission." See 35 ILCS 630/2(a) and 2(c). If telecommunications retailers provide these services, the charges for each must be disaggregated and separately stated from telecommunications charges in the books and records of the retailers. If these charges are not thus disaggregated, the entire charge is taxable as a sale of telecommunications.

Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2 (1996 State Bar Edition). The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3 (1996 State Bar Edition).

Sales of "canned" computer software are taxable retail sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. If the computer software consists of custom computer programs, then the sales of such software are not taxable retail sales. See subsection (c) of Section 130.1935.

Pursuant to 86 Ill. Adm. Code 130.1935, "Computer Software," enclosed, a license of software is not a taxable retail sale if:

- A) it is evidenced by a written agreement signed by the licensor and the customer;
- B) it restricts the customer's duplication and use of the software
- C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);

- D) the vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and
- E) the customer must destroy or return all copies of the software to the vendor at the end of the license period.

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax.

As stated above, a license of computer software is not taxable if it meets all of the criteria listed in Section 130.1935(a)(1)(A-E). However, subparagraph (D) requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. The Department has deemed a software license agreement to have met this criteria if the agreement does not contain such a provision, but the vendor's records reflect that it has a policy of providing copies of software at minimal or no cost if the customer loses or damages the software.

Subparagraph (E) also requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the license period. The Department has also deemed perpetual license agreements to qualify for this criteria even though no provision is included in the agreement that requires the return or the destruction of the software.

If only services are provided and no tangible personal property is transferred incident to that service, the charges for those services would not be subject to Retailers' Occupation Tax and Use Tax liability. However, if tangible personal property is transferred incident to the providing of a service, the transaction would be subject to the Service Occupation Tax Act.

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident to sales of service. See the enclosed copy of 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. The servicemen may calculate their tax base in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If the servicemen do not wish to separately state the selling price of the tangible personal property transferred, the servicemen must use 50% of the

entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred.

The third way servicemen may account for tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Serviceman may qualify as de minimis if the servicemen determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to the sale of service. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if the servicemen determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. The servicemen are not authorized to collect "tax" from their service customer nor are the servicemen liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Gina Roccaforte
Associate Counsel